



# DEPARTMENT OF THE TREASURY

## INTERNAL REVENUE SERVICE

TE/GE EO Examinations

MS:4957:DAL

1100 Commerce Street

Dallas, TX 75242

501.04-00

### TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

September 11, 2009

Number: **201318020**  
Release Date: 5/3/2013

Taxpayer Identification Number

#### LEGEND

ORG – Organization name

XX – Date Address – address

Form:

Tax Year(s) Ended:

ORG  
ADDRESS

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

#### CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear \_\_\_\_\_ :

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you accept our findings, please sign and return the enclosed Form 6018-A, *Consent to Proposed Action*. We will then send you a final letter revoking your exempt status.

If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In the event of revocation, you will be required to file Federal income tax returns for the tax period(s) shown above. If you have not yet filed these returns, please file them with the examiner as soon as possible, unless a report of income tax liability was issued to you with other instructions. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

If you do not agree with our position, you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Tract Mediation Services referred to in Publication 3498, do not apply to Exempt Organizations.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in the United States Tax Court, the United States Court of Federal Claims, or the United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Sunita B. Lough  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Form 6018-A Report of Examination  
Envelope

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b>		Year/Period Ended December 31, 20XX

LEGEND

ORG - Organization name      XX - Date      City - city      CO-1 - 1<sup>st</sup> COMPANY

**ISSUES**

1. Does **ORG** continue to qualify for tax exempt status under IRC section 501(c)(4)?
2. In the event **ORG** does not meet the requirements for recognition of exemption under the above mentioned subsection of the Code, should **ORG** be granted relief under section 7805(b) in connection with the revocation of its tax-exempt status under IRC section 501(c)(4)?

**FACTS**

The **ORG** ("ORG") was incorporated in 20XX to provide security in the form of police patrol for the homeowners of the CO-1. ORG was granted exemption as an organization described in IRC section 501(c)(4) in April 20XX.

The subdivision of ORG is comprised of 200 homeowners. In 20XX, about 104 homeowners are members of this association. Participation is not mandatory. Members pay yearly dues of \$.

ORG has contracted with the off-duty City police officers to provide police patrol during the day time and night time in the neighborhood. ORG rented the patrol cars from the City Police Department. ORG provides a cell phone to the police officer who is on duty so that any of the members can call the police officer in case of emergency. Non-members are not provided with the cell phone number. They will have to call 911 incase of an emergency.

ORG sends out fliers about the crime statistics in the area, Easter egg hunt, July 4<sup>th</sup> celebrations etc.

% of ORG's receipts are from membership dues. The only other income ORG has is interest income from its saving account. % of their expenses are program services related.

**LAW**

**Issue 1**

Internal Revenue Code Section 501(c)(4) organizations exempt from federal income tax are those "civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b>		Year/Period Ended December 31, 20XX

net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.”

Section 1.501(c)(4)-1(a) of the regulations further states that “an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.”

Revenue Ruling 74-99, 1974-1 C.B.131 concluded that a homeowners association, to qualify for exemption under section 501(c)(4) of the Code, (1) must serve a “community” which bears a reasonable recognizable relationship to an area ordinarily identified as governmental, (2) it must not conduct activities directed to the exterior maintenance of private residences, and (3) the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public

Revenue Ruling 69-280, 1969-1 C.B. 152 concluded that an organization that provides maintenance of exterior walls and roofs of members’ homes in a housing development does not qualify for tax-exempt status under IRC section 501(c)(4). The organization was operating primarily for the benefit of individual members rather than the community as a whole.

Revenue Ruling 74-17, 1974-1 C.B. 130 provided that an organization formed by the unit owners of a condominium housing project to provide for the management, maintenance, and care of the common areas of the project, as defined by State statute, with membership assessments paid by the unit owners does not qualify for exemption under section 501(c)(4) of the Code. Since the organization’s activities are for the private benefit of its members, it cannot be said to be operated exclusively for the promotion of social welfare. Accordingly, it does not qualify for exemption from Federal income tax under section 501(c)(4) of the Code.

Rev. Rul. 73-306, 1973-2 C.B. 179 provided that a nonprofit organization formed to protect the rights of tenants in one rental complex did not benefit the community in general, but rather a select group of individuals. Therefore, exemption under 501(c)(4) was denied.

Rev. Rul. 77-273, 1977-2 C.B. 195 concerned an organization that provides security services for residents and property owners of a particular community whose residents donate money at a specified hourly rate to pay for the services. The Service found that an entity that provided private security services, such as emergency rescue, guards for homes, businesses and construction projects, on a regular basis in return for certain compensation was carrying on a business with the general public in a manner similar to organizations operated for profit. The fact that the organization occasionally provided free services did not satisfy the requirements of the regulations.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b>		Year/Period Ended December 31, 20XX

In *Commissioner v. Lake Forest, Inc.*, 305 F. 2d 814(1962), it was held that the organization, a housing cooperative for World War II veterans and others, did not meet the requirements for tax-exempt status under IRC section 501(c)(4). The court found that the organization was not operating exclusively for "social welfare" purposes, but as a private economic enterprise. The court also determined that the organization was organized and operated for the benefit or convenience of its members by performing services that its members would otherwise have to provide for themselves,

## Issue 2

Internal Revenue Code section 7805(b) provides relief to an organization if the initial recognition of exemption was erroneous because of a misinterpretation of the applicable law by the Service, and the organization has relied on its exemption letter. If IRC section 7805(b) relief is granted, the revocation will be prospective.

Section 15.06 of Rev. Proc. 20XX-2, 20XX-1 I.R.B. 86 provides that generally, in all other circumstances, a Technical Advice Memorandum (TAM) or Technical Expedited Advice Memorandum (TEAM) revoking or modifying a letter ruling or will not be applied retroactively to the taxpayer for whom the letter ruling was issued or to a taxpayer whose tax liability was directly involved in the letter ruling, provided that –

1. there has been no change in the applicable law;
2. in the case of a letter ruling, it was originally issued for a proposed transaction; and
3. the taxpayer directly involved in the letter ruling, TAM, or TEAM acted in good faith in relying on the letter ruling, TAM, or TEAM and revoking or modifying it retroactively would be to the taxpayer's detriment.

## GOVERNMENT'S POSITION

Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes qualify for tax-exempt status under IRC section 501(c)(4). The subject organization contracts with the off-duty City police officers to provide police patrol services for the homeowners in the CO-1. The organization also sends out a flyer with latest crime statistics, forwards crime alerts from the City police to the members etc. As a result of our examination of your Form 990 for the period ended December 31, 20XX, we have determined that your organization no longer qualifies as an exempt social club described in IRC section 501(c)(4).

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b>		Year/Period Ended December 31, 20XX

We are also requesting that IRC section 7805(b) relief be provided to the organization. The organization was granted tax-exempt status under IRC section 501(c)(4) in April 20XX and has since relied on that ruling. Section 7805(b) relief may be granted to an organization when there is a misinterpretation or misapplication of the law and the organization obtained an erroneous ruling. The organization must have relied on that erroneous ruling, acting in good faith, and complied with all applicable law surrounding the ruling granted by the Service.

### **TAXPAYER'S POSITION**

ORG applied for and was granted tax-exempt status in 20XX. The organization has since relied on that ruling and filed the appropriate Form 990. The organization consents to the proposed revocation.

### **CONCLUSION**

As a result of our examination of your Form 990 for the period ended December 31, 20XX, we have determined that your organization no longer qualifies as an exempt social club described in IRC section 501(c)(4) as of January 1, 20XX.

### **ALTERNATIVE ISSUE**

#### **ISSUE**

Does **ORG** meet the requirements for recognition as a homeowners' association as described in IRC section 528?

#### **FACTS**

The **ORG** ("ORG") was incorporated in 20XX to provide security in the form of police patrol for the homeowners of the CO-1. ORG was granted exemption as an organization described in IRC section 501(c)(4) in April 20XX.

The subdivision of ORG is comprised of 200 homeowners. In 20XX, about 104 homeowners are members of this association. Participation is not mandatory. Members pay yearly dues of \$.

ORG has contracted with the off-duty City police officers to provide police patrol during the day time and night time in the neighborhood. ORG rented the patrol cars from the City Police Department. ORG provides a cell phone to the police officer who is on duty so that any of the members can call the police officer in case of emergency. Non-members are not provided with the cell phone number. They will have to call 911 in case of an emergency.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b>		Year/Period Ended December 31, 20XX

ORG sends out fliers about the crime statistics in the area, Easter egg hunt, July 4<sup>th</sup> celebrations etc.

% of ORG's receipts are from membership dues. The only other income ORG has is interest income from its saving account. % of their expenses are program services related.

## LAW

Internal Revenue Code section 528 provides an elective exemption for certain homeowners' associations. IRC § 528 exempts from income tax any dues and assessments received by a qualified homeowners' association that are paid by property owners who are members of ORG, where the assessments are used for the maintenance and improvement of association property.

Treasury Regulation §1.528-2 states that in order for an organization to meet the requirements of IRC section 528, the organization "must be organized and operated primarily for the purpose of carrying on one or more of the exempt functions of a homeowners' association." Exempt functions include "the acquisition, construction, management, maintenance, and care of association property."

Treasury Regulation §1.528-5 requires that at least sixty percent of a homeowners' association's gross income be that of exempt function income as defined in §1.528-9.

Section 1.528-6 of the regulations requires that at least ninety percent of a homeowners' association's expenditures must be "qualifying expenditures". Examples of qualifying expenditures may include the following:

1. "salaries of an association manager and secretary;
2. paving of streets;
3. street signs;
4. security personnel;
5. legal fees;
6. upkeep of tennis court;
7. swimming pools;
8. recreation rooms and halls;
9. replacement of common building, facilities, air conditioning, etc.;
10. insurance premiums on association property;
11. accountant's fees;
12. improvement of private property to the extent it is association property; and
13. real estate and personal property taxes imposed on association property by a State or local government."

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b>		Year/Period Ended December 31, 20XX

Treasury Regulation §1.528-9 excludes from federal income tax, receipts considered exempt function income. Examples of exempt function income include dues and assessments for the purposes of-

1. "paying the principal and interest on debts incurred for the acquisition of association property,
2. paying real estate taxes on association property,
3. maintaining association property,
4. removing snow from public areas, and
5. removing trash."

### GOVERNMENT'S POSITION

Based on the facts and circumstances of the organization, we recommend the organization elect recognition under IRC section 528 and file Form 1120-H, *U.S. Income Tax Return for Homeowners' Associations*, for the fiscal year ended December 31, 20XX and all future years.

### TAXPAYER'S POSITION

The organization has agreed to complete Form 1120-H, *U.S. Income Tax Return for Homeowners' Associations*, for the fiscal year ended December 31, 20XX and all future years. The organization has been notified of the requirements for recognition as a homeowners' association under IRC section 528.

### CONCLUSION

We recommend **ORG** elect recognition under IRC section 528 as a qualified homeowners' association. Form 1120-H, *U.S. Income Tax Return for Homeowners' Associations*, must be filed for the year ended December 31, 20XX and all future years.